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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1959

No. 449

[redacted] CLAUDIO SEZ, CHARLES SCHWARTZ and RANDOLPH PHILLIPS, individually and on behalf of all other [redacted] THE PENNSYLVANIA RAILROAD COMPANY, [redacted]

[redacted] CLARK, MELLON, ROBERT T. McCRACKEN, C. EARLE INGERSOLL, WALTER S. FRANKLIN, JAMES E. GOWEN, PHILIP R. CLARKE, JAMES M. SYMES, JOHN V. DEMAND, JOHN B. HOLLISTER, LAMMOT du P. COPE AND DONALD DAVENPORT, R. GEORGE RINGFIELD, WILLIAM J. DAY, OTTO N. FRENZEL, FRED CARR, DAVID C. BEVAN, JAMES P. NEWELL, BAYARD H. ROBERTS,

and

PENNSYLVANIA RAILROAD COMPANY, a corporation [redacted]

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. _____

LOUIS GAUDIOSI, CHARLES SCHWARTZ, and RANDOLPH PHILLIPS, individually and on behalf of all other stockholders of THE PENNSYLVANIA RAILROAD COMPANY similarly situated,

Petitioners,

v.

RICHARD K. MELLON, ROBERT T. McCRACKEN, C. JARED INGERSOLL, WALTER S. FRANKLIN, JAMES E. GOWEN, PHILIP R. CLARKE, JAMES M. SYMES, JOHN A. DIEMAND, JOHN B. HOLLISTER, LAMMOT DU P. COPELAND, DONALD DANFORTH, R. GEORGE RINCLIFFE, WILLIAM L. DAY, OTTO N. FRENZEL, FRED CARPI, DAVID C. BEVAN, JAMES P. NEWELL, BAYARD H. ROBERTS,

and

THE PENNSYLVANIA RAILROAD COMPANY, a corporation incorporated under the laws of the Commonwealth of Pennsylvania,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioners pray that a writ of certiorari issue to review four judgments of the United States Court of Appeals for the Third Circuit, entered on June 24, 1959 in Appeals Nos.

12,618, 12,744, 12,745, and 12,759 which affirmed final judgments entered by the District Court for the Eastern District of Pennsylvania dismissing the complaints in Civil Action Nos. 24,456 and 24,654.

Opinions Below

The opinion of the Court of Appeals is as yet unreported but is printed as Appendix A, *infra*. The opinion of the District Court in Civil Action No. 24,456 is unreported but is printed in the record herein (No. 12,618 in the Court of Appeals, Appellants' Appendix, p. 3a et seq.). The opinion of the District Court in Civil Action No. 24,654 is reported at 166 F. Supp. 353 and is printed in the record herein (No. 12,742-12,745, Appellants' Appendix, p. 6a et seq.).

Jurisdiction

The orders of the Court of Appeals were entered on June 24, 1959 and petitions for rehearing en banc were denied without opinion on August 28, 1959. The jurisdiction of this Court is invoked under Sec. 1254(1) of the Judicial Code. 28 U. S. C. A. § 1254(1).

Questions Presented*

Petitioners' candidate for a 4-year term, expiring 1962, of the 18-member board of directors of The Pennsylvania Railroad Company received the votes of 23,000 minority stockholders, sufficient to elect him at the May 13, 1958 election as the first minority director in the Company's 112-year history. Respondents herein (the management directors and the Company) claimed that revocations of

* This is a joint petition with respect to 4 different appeals from 3 district court judgments entered on May 6, 1958; August 18, 1958 and October 22, 1958. For convenience and to avoid repetition the docket numbers of the appeals in the Court of Appeals precede the related questions.

proxies sufficient to defeat him were lawfully obtained, the District Court (E. D. Pa.) so found after trial on the merits in two different civil actions, and dismissed the complaints. The Court of Appeals refused to review the issues on the merits on the ground that in the second case the candidate had come into equity with "unclean hands" because he had sent a telegram to 2 Swiss banks in violation of the S. E. C. proxy rules that intimidated them from voting stock which they did not own and for which they had no authorizations to vote.

The questions presented are—

(No. 12,745)

1. Are not facts showing "unconscionable" conduct and "corrupt intent" indispensable, and under the decisional law of this Court must they not be pleaded, tried and found before a plaintiff may be barred from equitable relief on the ground of "unclean hands"?

2. Does an 8-day violation, during the heat of a proxy contest for one seat on an 18-member board between small stockholders and the management of a 2-billion dollar corporation, of an S. E. C. filing rule, corrected immediately upon agency notification, followed by simultaneous withdrawal of the challenged representations 5 days before the election and 1 day prior to the filing of the complaint, accompanied by petitioner's reliance thereafter on judicial remedies, without further objection by the S. E. C., constitute coming into equity with "unclean hands" within the meaning of the decisional law of this Court?

(Nos. 12,618 and 12,744)

3. May the 2 innocent petitioners herein be barred from access to a Court of Appeals for review of the two District Court judgments on behalf of themselves and the 23,000 minority stockholders on the ground that to review their claims for enforcement of their own legal and equitable rights, including the right to money damages and a fair election under the State Constitution and Statutes and

under the federal Securities Exchange Act of 1934, might "further" the candidate's election?

4. Is such a denial of review by a Court of Appeals to 2 petitioners, where there is no finding that either had any knowledge of or participation in the sending of the "unclean" telegram, a denial of their constitutional right to due process of law and of the right of appeal guaranteed by the Judicial Code?

(Nos. 12,744; 12,745)

5. Is not S. E. C. proxy rule X-14A-2(a) a complete defense to the "unclean hands" charge, since it provides that the proxy rules do not apply to "Any solicitation made otherwise than on behalf of the management of the issuer where the total number of persons solicited is not more than ten", and the record here discloses that the telegrams were sent only to 2 Swiss banks and to no other person, and that after the telegrams' filing and amendment the S. E. C. made no further objection? May the Court of Appeals pass on this defense *sub silentio*?

6. Where there is no prior administrative or judicial interpretation making an exemption from a federal proxy rule not available, may petitioner be found to have "deliberately and maliciously" violated it?

7. Where Count V, the sole cause of action seeking relief with respect to the Swiss banks and seeking to enjoin them from voting stock they did not own and for which they had no authorization to vote, was dismissed on consent of all the parties, and none of the findings of fact nor conclusions of law constituting the ruling of "unclean hands" was pleaded nor tried by consent and the complaint was never amended to allege any one of them, was there any proper basis for the ruling of "unclean hands"? Was there a violation of Federal Rules of Civil Procedure Nos. 8, 9(b) and 15(b)? May a Court of Appeals pass over these issues *sub silentio*?

8. Assuming petitioner had "unclean hands" that barred any "equitable relief", could the Court of Appeals

extend the scope of that maxim to bar review of the District Court judgment insofar as it dismissed claims for money damages and the enforcement of legal rights and remedies, as distinct from equitable ones, under the State Constitution and Federal and State Statutes?

(Nos. 12,618; 12,744; 12,745)

9. Did the Court of Appeals violate *sub silentio* the rule of *Erie* v. *Tompkins*, 304 U. S. 64 as applied in *Ragan* v. *Merchants Transfer & Warehouse Co.*, 337 U. S. 530, 533, by affirming the equitable defense of "unclean hands" to bar review of petitioners' claims for enforcement of their legal rights under the Constitution of the State of Pennsylvania (Articles I, § 5; XVI, § 4; XVII, § 2) and under the State Statutes (12 P. S. § 2022-III; § 2040 and 67 P. S. § 62) and the common law in these 2 diversity suits (Counts I & IV, Civil Action No. 24,456; and Counts I & IV, Civil Action No. 24,654),

(a) where the Supreme Court of Pennsylvania has ruled without exception that "unclean hands" is not available as a defense to bar "legal rights" nor to bar "a substantive right under the statutory law of the State" (*Colonial Trust Co.* v. *Central Trust Co.*, 243 Pa. 268, quoted in *Manufacturers Finance Co.* v. *McKey*, 294 U. S. 442, 449-450; *First Nat'l Bk. & Trust Co.* v. *Jaffe*, 322 Pa. 144, 146; *Houghton* v. *Restland*, 343 Pa. 625, 635);

(b) where "it is well settled" in Pennsylvania that equity has no jurisdiction "to determine the right to a corporate office or the validity of a corporate election" (*Cella* v. *Davidson*, 304 Pa. 389 and other cases as cited in *Johnson* v. *Horton*, 63 F. 2d 950, 952-3 (9 Cir.); *Whyte* v. *Faust*, 281 Pa. 444; *Ahl's Appeal*, 129 Pa. 49, 61, 62; *Bedford Springs Co.* v. *McMeen*, 161 Pa. 639); and

(c) where this Court has explicitly ruled in *Ragan* (337 U. S. at 533) that when the "cause of action is

created by local law, the measure of it is to be found only in local law" and it is subject only "to the same defenses in the federal court as in the state court"?

10. Where all claims for equitable relief (namely, enjoining the holding of the corporate election and the use of proxies therein) under the federal Securities Exchange Act are moot (because the election has been held), and only legal rights and remedies survive thereunder, including claims for money damages and for declaratory judgment of the legal rights and liabilities of the parties (Counts II & III, Civil Action No. 24,456; and Counts II & III, Civil Action No. 24,654),

(a) did the Court of Appeals on the ground of "unclean hands" err in denying review on the merits of the judgments dismissing these federal claims?

(b) is such a denial proper when there is at issue the enforcement of the legal rights and remedies of 23,000 minority stockholders, the statute has been enacted "in the national public interest" (§ 2), and Congress has vested in the federal courts jurisdiction "of all suits in equity *and actions at law* brought to enforce any liability or duty created by this title or the rules and regulations thereunder" (§ 27)?

(c) assuming any equitable rights or remedies survive is "unclean hands" available as a defense when Congress has not so legislated in the statute?

(No. 12,759)

11. Where this Court in *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U. S. 541 upheld the constitutionality of a New Jersey statute requiring stockholder plaintiffs in a derivative suit to post security for costs if they did not hold 5% or $50,000 in market value of the company's stock, and plaintiffs herein in this derivative suit attacked the constitutionality of a Pennsylvania statute that omitted the $50,000 option, was not the District Court required under

Harrison v. *N. A. A. C. P.*, 359 U. S. 167 and the cases cited therein (pp. 176-177), to withhold adjudication of that issue until the state courts had a reasonable opportunity to pass upon the issue?

12. Does a state statute which requires plaintiffs to hold $7,900,000 in market value of a company's stock in order to avoid posting security for costs, deprive plaintiffs of their constitutional rights to equal protection under the law?

Statutes and Rules Involved

Rule X-14A-2(a) of Regulation X-14 (the proxy rules) of the S. E. C. promulgated pursuant to Sec. 14 of the Securities Exchange Act of 1934 (15 U. S. C. § 78n) will be found in 17 C. F. R. § 240, 14a-2(a). Said rule states in pertinent part:

> **"Rule X-14A-2. Solicitations to Which Rules Apply.**
>
> The rules contained in this regulation apply to every solicitation of a proxy with respect to securities listed and registered on a national securities exchange, whether or not trading in such securities has been suspended, except the following:
>
> (a) Any solicitation made otherwise than on behalf of the management of the issuer where the total number of persons solicited is not more than ten."

Rule X-14A-9 will be found in 17 C. F. R. § 240, 14a-9. It provides:

> **"Rule X-14A-9. False or Misleading Statements.**
>
> No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting, or other communication written or oral containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary to correct any statement in

any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

The State Constitutional provisions and statutes involved and which petitioners seek to enforce are the following sections of the Constitution of the State of Pennsylvania (See Purdon's Pa. Statutes, Constitution):

"Article I, * * *

Sec. 5. Elections shall be free and equal."

"Article XVI * * *

Sec. 4. In all elections for directors or manager of a corporation, each member or shareholder may cast the whole number of his votes for one candidate or distribute them upon two or more candidates as he may prefer."

Title 12 Purdon's Pa. Statutes provides:

"Sec. 2040. *Effect of writ in contested election cases.*

"In all questions arising on writs of quo warranto between persons claiming to be duly elected to fill any office, it shall be lawful for the court trying the same, to decide both on the legality of the election of the party claiming said office, as also of the party in possession of the same, and if judgment of ouster is given against the party in possession, said court may decree that the office shall be held by the person or the persons who they shall be of opinion is duly elected; and after judgment of ouster, when it cannot be ascertained who is duly elected, said court may order a new election to fill said office, to be held at such times thereafter as shall be appointed by such court."

Title 67 Purdon's Pa. Statutes § 62 provides:

"Every railroad or canal corporation, organized in this state, shall maintain an office therein for the transaction of its business, where transfers of its stock shall be made and books kept for the inspection,

by any stock or bondholder or any other person having any pecuniary interest in such corporation, in which shall be recorded the amount of capital stock subscribed or paid in and by whom, the names of the owners of its stock and the amounts owned by them respectively, the transfers of said stock, and the names and places of residence of its officers."

Article XVII, § 2, of the State Constitution is to the same effect. (See Purdon's Pa. Statutes, Constitution, Art. XVII, § 2.)

Statement of the Case

The issues herein stem from the fact that, upon the nomination of Lewis D. and John J. Gilbert, some 23,000 minority stockholders voted on May 13, 1958 to elect Randolph Phillips their representative on the 18-member board of directors of The Pennsylvania Railroad Company for a 4-year term expiring in 1962; and cast sufficient votes to elect him as the first minority director in the company's 112-year history.

Disregarding management proxies admittedly obtained by acts challenged in the two civil actions herein, Phillips was elected by 11,201,898 cumulative votes to 8,137,430 for the 6 management candidates.[1] Giving effect to the revocations alleged in the 2 complaints to be unlawfully obtained, he was defeated by 9,004,766 votes to 5,997,982. Thus his election or defeat and the disenfranchisement of 23,000 stockholders, owning a minimum of 18 million dollars worth of stock or roundly 1,000,000 to 1,800,000 shares, depend

[1] Finding 51 of the District Court shows that Phillips admittedly received 5,997,982 votes (166 F. Supp. at 367). A letter report by the Judges of Election (Appellants' Appendix, Nos. 12,742-12,745, p. 62a) shows that they certified as lawful and valid defendants' revocations of proxies for 867,336 shares, or 5,204,016 cumulative votes, previously voted for Phillips. These are the revocations whose legality is in dispute. Adding these 5,204,016 votes to the 5,997,982 certified by the Judges results in a total of 11,201,898.

upon the determination on the merits of appeals by the 3 petitioners herein by the Court of Appeals.

The Court of Appeals refused, however, to make such a determination; it failed to review any of the substantive issues as decided by the District Court for the Eastern District of Pennsylvania in dismissing after trial on the merits the complaints in the 2 civil actions challenging the methods by which the management directors won the election. Instead, by the device of affirming a ruling in the second civil action that the candidate had come into equity therein with "unclean hands" (because of a telegram sent by him to 2 Swiss banks) it sought to avoid a review of the questions whether defendants had secured the crucial proxy revocations in violation of the legal rights of petitioners and their 23,000 associated minority stockholders under Articles I, § 5; XVI, § 4 and XVII, § 2 of the State Constitution of Pennsylvania, certain State statutes and the S. E. C. proxy rules under Sec. 14(a) of the federal Securities Exchange Act of 1934.

The Issues Below

(No. 12,618)

On April 9, 1958 petitioners Louis Gaudiosi and Charles Schwartz as small stockholders of The Pennsylvania Railroad Company, and Phillips as the minority nominee, filed their complaint in Civil Action No. 24,456 against the company and its directors in the United States District Court for the Eastern District of Pennsylvania with respect to the Annual Meeting and Election to be held on May 13, 1958. The action was both individual and representative. Plaintiffs sought a declaratory judgment declaring and enforcing their legal rights and injunctive relief.

Of the 18 directors of the Company, 6 were to be elected for a 4-year term, expiring 1962, at the 1958 election. Together with the 6 management nominees and the minority

nominee there were thus 7 candidates for election. But the proxy form distributed by the Company to the 147,000 stockholders of record provided no means for the stockholder to exercise his cumulative voting right under Article XVI, § 4 of the Constitution of the State of Pennsylvania "to cast the whole number of his votes for one candidate or distribute them upon two or more candidates as he may prefer." The only form distributed by the Company was an authorization to vote for all 6 management candidates. Petitioners contended under Count I of their complaint that this proxy form made it impossible for the stockholder to exercise his constitutional rights, and that the Company and its directors had a fiduciary duty to make available to each stockholder a proxy form similar to the ballot to be made available at the election itself. Otherwise it was impossible for the stockholder to "distribute" his votes, as the Constitution provided, upon only 5 or a lesser number of management nominees, or "to cast the whole number of his votes" for a single management nominee or for the minority nominee, or to "distribute" his votes upon 5, or a lesser number of management nominees, *and* the single non-management nominee. Plaintiffs claimed that the management directors had no lawful right to use Company funds and facilities to distribute a proxy form that constituted a means of frustrating or negating the stockholders' constitutional rights. The form obviously frustrated the rights of the stockholder who was independent of both the majority and minority factions, and who wished as the Constitution provided, to "split the ticket." Thus Count I raised solely an issue of Pennsylvania law over which the Securities & Exchange Commission had no jurisdiction, inasmuch as the Securities Exchange Act of 1934 provides the S. E. C. with no power to enforce fiduciary obligations arising out of the State Constitution and the S. E. C. does not enforce State law or State-created rights. In addition the Act provides that "the rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity." 15 U. S. C.

§ 78bb(a). The District Court dismissed Count I after trial on the ground that the individual defendants and the defendant company had not violated any legal, equitable or fiduciary duty. It did not explain its reasons. (See Appellants' Appendix, No. 12,618, p. 3a et seq.); and the Court of Appeals has refused to review the issue.

Count II of the complaint was filed under the Securities Exchange Act and alleged a violation of the proxy rules thereunder and specifically of Rule X-14A-9 in that the Company failed to disclose to the stockholders that under the proxy form distributed by it the constitutional right of the stockholder was *impossible* of exercise. Plaintiffs further contended that the proxy statement of management was false and misleading in that it represented that the stockholders "may, if they desire, exercise cumulative voting rights" without disclosing they had to be present at the meeting to do so where the only ballot so permitting was distributed by the Company; and that the management had failed to disclose that such rights could not be exercised pursuant to the proxy form enclosed with the proxy statement and with subsequent proxy soliciting letters. This count was likewise dismissed on the merits, and has not been reviewed.

Count III of the complaint was also filed under the Securities Exchange Act and alleged that defendants had further violated the proxy rules by false and misleading representations with respect to the minority candidate in that they had represented in a letter to the 147,000 stockholders dated April 2, 1958 that he had gained "public attention over the past 15 years through his activities in proxy fights and as a frequent plaintiff in law suits against well-known corporations, including a number of important railroads. As far as we know, he does not have any other principal occupation." These representations were alleged to be false or misleading since he had not been a *principal* in any proxy fights "against well-known corporations, including a number of railroads" during the last 10 of the 15 years referred to, but instead was a consultant to and acted

on behalf of such corporations, instead of against them.* It also omitted the fact that his activities were not in *personal* but in *representative* law suits on *behalf* of the Company's stockholders. (*Brescick & Co., et al.* v. *U. S.*, and *Alleghany Corporation*, 353 U. S. 151). Thus the letter falsely represented his past activities and omitted material facts in violation of Rule X-14A-9. This count was also dismissed on the merits, although the court failed to mention or discuss the proof thereunder, and also has not been reviewed.

Count IV of the complaint was based on diversity and alleged that defendants' use of the Company's funds to procure their election was in violation of their common law duties and obligations and their duties under Article XVI, § 4 of the Constitution. The Court dimissed this count for lack of jurisdiction on the ground that the alleged illegal expenditure was "wholly insufficient to create an amount in controversy as between the Plaintiffs, or any of them, and Defendants, under Count IV, in excess of $3,000." Plaintiffs contend that this is an error of law since it is the value of the right or property held by plaintiffs whose protection is sought that creates the jurisdictional amount (*Hunt* v. *New York Cotton Exchange*, 205 U. S. 322) and the plaintiff candidate was found to have spent more than $3,000 to establish and protect his right to a fair election. (No. 12,618, Appellants' Appendix, p. 9a, Finding 33). This issue also has not been reviewed.

The complaint was dismissed on May 6, 1958 on which date the court also entered its findings of fact and conclusions of law. But the decision is barren of any citation to any judicial authority, state or federal, and at no point discussed the citations of plaintiffs. During the entire course of the trial and to date the district court sealed

* The record shows he was retained in proxy and other matters by the Chesapeake & Ohio Ry. Co., Alleghany Corporation, Thermoid Co., and Utah Southern Oil Co. (Unprinted record, No. 12,618, N. T. 50-62; Ex. "1" to complaint.)

against plaintiffs the list of 34,000 holders of 100 or more shares, owning more than 80% of the stock, that had been provided by the company to the management candidates for their solicitations. No inspection of this sealed list was allowed plaintiffs; it apparently being the court's position that they should go to the company's "books" and copy *by hand* the 34,000 names, addresses, and shareholdings, all of which had been selected from a total of 147,000 stockholders of record by the Company's electronic computer and then mechanically reproduced.

(Nos. 12,744; 12,745; 12,759)

On May 9, 1958 plaintiffs filed their second complaint against the same defendants in the same court in which they alleged in Count I they had been denied the aforesaid list or copies of it similar to those furnished the management candidates, and that the management candidates were using the funds, facilities, and personnel of the Company to solicit proxies while these were being denied the minority candidate. The trial disclosed that some $160,000 of company funds had been used to procure the re-election of the 6 management nominees, that 255 officers and supervisory employees had been used to solicit proxies for the management, including 10 Vice Presidents, 5 Assistant Vice Presidents, and 240 operating, engineering, sales, traffic, financial, legal and other officers and employees.* Nevertheless the District Court found no violation of any legal, equitable, or constitutional rights of the minority. Yet, Article I, § 5 of the Constitution of the State of Pennsylvania requires that "Elections shall be free and *equal*" and both political and corporate elections come within the purview of the constitution. The Constitutional Debates show that Article XVI, § 4, the mandatory cumulative voting provision, was adopted "in all elections for directors

* Such use of company funds and facilities is improper unless control of the company or of its policies is at stake. See cases collected in *Rosenfeld* v. *Fairchild Engine Co.*, 309 N. Y. 168, (1955). Here there was only a contest for one seat on an 18-member board.

• • • of a corporation" expressly "to allow the *minority* of the stockholders" of The Pennsylvania Railroad Company, among others, "to have a voice in the management of its affairs • • • *to protect the small stockholders* against those who have large numbers of shares • • • *against the majority* who are running it in their own interest." (See Debates of the Constitutional Convention of 1874, edited by Buckalew, Vols. 4 and 5, pp. 593, 761, 762). Opponents of the cumulative voting provision argued that the minority "could elect Satan to be a director" of The Pennsylvania Railroad Company (p. 593). Petitioners contended in both the District Court and the Court of Appeals that in the light of this constitutional provision and the intention of the constitutional convention it was an abuse of trust for the majority directors to use the company's funds, facilities and personnel exclusively to procure election of the majority's candidates while denying any such use to the minority. The District Court reached a contrary view without citation of any authority, judicial or otherwise, and without mentioning the constitutional debates and purpose (166 F. Supp. 353; Appellants' Appendix Nos. 12,742-12,745, p. 6a *et seq.*). The Court of Appeals has refused to review the issue.

Count IV of the complaint was based on the same facts as Count I, but included both an individual cause of action on behalf of the plaintiffs for recovery of some $27,000 of funds expended by them and for damages for denial of a fair election; and it also pleaded a derivative cause of action to recover the $160,000 of company funds admittedly expended by the management directors to procure re-election of their nominees. The District Court for an undiscernible reason denied jurisdiction over plaintiffs' individual damage action, despite findings of diversity and of expenditure by plaintiffs in excess of $3,000. (166 F. Supp. at 353; 359 Appellants' Appendix, Nos. 12,742-12,745, at pp. 7a, 8a, 30a). And the Court of Appeals has declined to review this purely legal issue.

After the derivative cause had been tried and was *sub judice*, defendants moved that plaintiffs be required to post

security for costs under a Pennsylvania statute that permitted such a demand where the plaintiffs held less than 5% of the outstanding stock. Unlike most such state statutes the Pennsylvania statute (12 Purdon's Pa. Statutes §§ 1321-1323) omitted an alternative provision that no security need be posted if plaintiffs held $50,000 or more of the company stock.[1] Plaintiffs therefore attacked the statute as unconstitutional, since to avoid posting security they would be required to hold some $7,900,000 of stock and to apply the statute in these circumstances would deprive them of their constitutional right to equal protection under the law. The District Court passed over the constitutional objection *sub silentio*, ordered the posting of a $3,000 bond, and that the derivative count be reserved for further trial on the ground that plaintiffs had neither tried nor briefed it adequately.[2] When thereafter defendants objected that plaintiff Gaudiosi had posted a $3,000 bond which was not in proper form, the court dismissed the complaint.[3] On appeal the Court of Appeals affirmed, holding that in *Knapp* v. *Bankers Securities Corporation*, 230 F. 2d 717 (1956) and *Murdock* v. *Follansbee Steel Corp.*, 213 F. 2d 570, both 3 Cirs., it had implicitly decided the constitutional objection. (Appendix A, p. 10.) The constitutional issue was not raised in either case, either explicitly or implicitly. This is the sole issue in No. 12,759.

Count II of the second complaint alleged that defendants' proxy soliciting letter to the 147,000 stockholders dated April 16, 1958 violated the Securities Exchange Act of 1934 and was false or misleading in various respects, and Count III made the same allegations with respect to a letter dated May 2, 1958. After 384 pages of testimony had been taken on these issues the District Court an-

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[1] See Appendix D hereafter.

[2] See 166 F. Supp. 351 and Appellants' Appendix, Nos. 12,742 12,745, pp. 25a, 34a, 38a. The district court ignored the rule that the burden of proof shifted to the fiduciaries. *Pepper* v. *Litton*, 308 U. S. 295, 306.

[3] See Appellants' Appendix, No. 12,759, pp. 7a; 4a.

nounced on June 10, 1958 that it would continue a restraining order issued on June 4, 1958 prohibiting the seating of the 6 management candidates, stating "that the evidence thus far adduced on the plaintiffs' behalf is sufficient to enable a fact finder, if believed and accepted, to find that one or more of the statements in the letters complained of were false and misleading and material." (Appellants' Appendix in Nos. 12,742-12,745, at pp. 70a-71a). When the trial was resumed and concluded on July 1, 1958 on these issues, defendants offered no additional evidence to support the truth of 17 of the 18 challenged representations. At no time did the signer of the letters nor any defendant take the stand in support of their truth nor to rebut plaintiffs' evidence. Nevertheless on August 18, 1958, when final judgment was entered dismissing the complaint and notwithstanding that all of plaintiffs' evidence on these issues had been accepted into the record, the court found none of the statements false or misleading or omissive of material facts.

Perhaps the most striking example of the District Court's attitude was shown by the fact that it ruled as neither material nor necessary for disclosure the fact that findings of the S. E. C. adverse to petitioner Phillips' reputation as a "watchdog" for minority stockholders, which were quoted at length in the management letter of May 2, 1958 (Appellants' Appendix, Nos. 12,742-12,745, at pp. 53a-54a), had been "annulled and voided" as "unfair and inequitable" and "not supported by substantial evidence" by the United States District Court at Wilmington which reviewed the S. E. C. decision. (Id., p. 56a). Said decision had initially been reversed in the Court of Appeals (*In re The United Corporation*, 3 Cir., 249 F. 2d 168) and upon settlement of the order below both the S. E. C. and the United Corporation had agreed to the correctness of the order's recitals. Yet the District Court in Philadelphia without any jurisdiction in the premises made a collateral attack on the Wilmington court's order and found that the order of set-

tlement exceeded the Court of Appeals mandate and that thus the order and its recitals were not material facts and the failure to disclose them while only disclosing the reversed S. E. C. findings adverse to Phillips did not make the letter false or misleading. (Id., pp. 21a-23a). Review of this issue by the Court of Appeals was denied by its action herein.

The District Court sustained as fair and truthful a long and repetitive attack on Phillips by the Pennsylvania Railroad Company through 3 letters sent to its 147,000 stockholders, and the Court of Appeals has denied any review of the lower court's judgment despite the fact that the attack vitally affected the proxy contest and the public reputation of Phillips. It thus denies review of defendants' letters to 147,000 stockholders, which letters are alleged to be false and misleading and in violation of the S. E. C. proxy rules, on the ground that Phillips' one telegram to 2 Swiss banks violated the same rules and thus constituted "unclean hands" depriving him and his 23,000 associated stockholders of any opportunity to have the Court of Appeals determine whether defendants 3 letters to 147,000 stockholders violated the same rules and thus would render defendants "unclean", and the election for the 4-year term void.

The "unclean" telegram

On April 30, 1958 petitioner Phillips sent the following telegram, identical except for the number of shares mentioned therein, to 2 Swiss banks, the Credit Suisse and the Swiss Bank Corporation:

> "I understand that your Bank which is the nominee for 360,918 shares of Pennsylvania Railroad Co. capital stock intends to vote said stock for the 6 management nominees for director at the Railroad's annual election to be held on May 13, 1958, without informing the owners of said stock of the contest for directors now existing and without giving them an opportunity to determine for themselves whether

or not their stock should be voted and without giving them an opportunity to vote for myself as the 1 non-management nominee for director, or for the 6 management nominees, or for 5 or less of the management nominees and the 1 non-management nominee. Such arbitrary and undemocratic action by your Bank not only violates American equitable and common law principles applicable to banks when they act as fiduciaries but also violates the rules of the Securities and Exchange Commission and New York Stock Exchange as well as American banking practices applicable to all stock exchange brokers and banks in this country. It is a violation of the concept of a free and fair election on a fully informed basis, it constitutes a fraud upon the stockholders, and can only be of comfort to dictators and totalitarians in or out of corporation management.

"Such action by your Bank also constitutes a combination with the Pennsylvania Railroad management and other company managements that is prohibited under the anti-trust laws of this country and which are applicable to your Bank since it is doing business in the United States.

"Such improper practices which already have been criticised in the United States Senate threaten to damage immeasurably myself and many thousands of associated stockholders. Unless you give me prompt assurance of the immediate termination of these practices I will reluctantly be compelled to take prompt and appropriate legal action in the courts. Kindly advise me by return wire of your answer to this telegram."

The District Court ruled, and the Court of Appeals affirmed, that "prior submission" to the S. E. C. for "clearance" was "required by Rule X-14-A-1, et seq. of the Securities Exchange Act". (Appendix, p. 13a).

Both courts' opinions are totally devoid of any mention of petitioner's defense, namely that proxy Rule X-14a-2(a) excepts from the operation of the proxy rules "Any solicitation made otherwise than on behalf of the management of the issuer where the total number of persons solicited is

not more than ten." 17 C. F. R. § 240, 14a-2(a) (p. 7, supra.) Since the Court found that the telegrams were sent to only 2 persons, that is the 2 Swiss banks, this rule on its face provides a complete defense to the prior failure to file and "clear" the telegram with the S. E. C. There is no judicial precedent nor any administrative ruling or precedent, and none is cited by the court for making this exception unavailable because there has been a prior solicitation by a *different* document of more than 10 persons. Yet a lawyer for the S. E. C. proxy division suddenly decided so to interpret the rule upon The Pennsylvania Railroad Company's urging. (Nos. 12,742-12,745 below, Appendix for Appellees pp. 42a-43a).

Thereupon, and under protest, Phillips on May 8, 1958 filed the April 30th telegram with the S. E. C. Since under the S. E. C. rules, material so filed must be "cleared" as to content before being used as proxy material, Phillips simultaneously sent to the 2 Swiss banks and filed with the S. E. C. on May 8, 1958 a telegram of withdrawal as follows:

> "I hereby withdraw all statements in my telegram to you dated April 30, 1958 except the first sentence, and I hereby substitute in place of said withdrawn statement the statement that 'If said stock is voted by your Bank I reserve all rights in law and equity to take legal and other appropriate action against you for just and equitable relief' ". (See Appendix A, p. 14)

This second telegram thus withdrew all the controversial statements in the first telegram.

The S. E. C. thereupon made no further objection.

Upon these facts the District Court nevertheless ruled that the first telegram contained false and misleading statements in violation of proxy rule X-14A-9; that in sending the first telegram petitioner was "knowingly, maliciously and intentionally violative of the applicable Rules of the Securities and Exchange Commission" (Conclusion of Law

No. 24 and 25, Appendix in Nos. 12,742-12745, p. 33a) and thus on May 9, 1958 when the complaint in the second civil action was filed he "came into equity with unclean hands" that "bar the grant to Phillips of any equitable relief". (Id., Nos. 26 and 27)

The court cited for authority *Precision Instrument Mfg. Co.* v. *Automotive Maintenance Machinery Co.*, 324 U. S. 806 (1945); *Keystone Driller Co.* v. *General Excavator Co.*, 290 U. S. 240 (1933); *Holst* v. *Butler*, 379 Pa. 124 (1954); *Vercesi* v. *Petri*, 334 Pa. 385 (1939)." (Id., Conclusion 26). In the *Precision* case the parties were "steeped in perjury" (324 U. S. at 810-815); in the *Keystone* case, there was concealment of evidence and procurement of a false affidavit (290 U. S. at 243-245); and in the *Holst* and *Vercesi* cases the Pennsylvania Supreme Court refused to apply the "unclean hands" doctrine despite allegations of violation of a statute prohibitng a government employee to receive money or property for aiding in procurement of a government contract (the *Holst* case) and allegations that a plaintiff had arranged to hide and conceal assets from a creditor (the *Vercesi* case). All the cases cited by the District Court and the Court of Appeals related to acts of criminality or actual fraud or corruption. It is clear that no "corrupt intent" was shown here and that the "unclean hands" findings are a distorted and exaggerated application of the doctrine, serving merely as an artificial and convenient excuse to avoid appellate review on the merits.

Pomeroy in EQUITY JURISPRUDENCE states "*A wrong which has been righted* (emphasis in original) may not be pleaded against a party to a suit in equity, on the theory that the party charged therewith is in court with 'unclean hands.'" (§ 399, p. 100).

The Court of Appeals, to overcome this doctrine, ruled that the first telegram despite its filing and amendment had intimidated the 2 Swiss banks from voting 700,000 shares of

stock which they did not own, and for which they had no authorizations to vote. (See Finding 66 in printed record, Nos. 12,742-12745 at p. 30a, which shows the banks had no instructions to vote the stock.) No witness from the Swiss banks testified. The Court of Appeals reasoned as follows:

> "They withheld the remaining 700,000 shares, as found by the District Court, as the direct result of the receipt of Phillips' telegram of April 30, 1958.
>
> That that is so is made manifest by these circumstances; the so-called 'withdrawal' telegrams of May 9th specifically contained the threat that if the stock of the Swiss banks was voted for management nominees Phillips reserved 'all rights in law and equity to take legal and other appropriate action' against the banks; Phillips the very day that the telegrams were sent filed an amendment to his second complaint by adding the Swiss banks as defendants and copies of the amended complaint were served on the Swiss banks on May 12, 1958; and May 9th, the day the telegrams were sent, was Friday and the week-end intervened between that day and Tuesday, May 13th when the annual meeting took place.
>
> The foregoing negatives Phillips' contention that the telegrams of May 9th had 'righted' any wrongs committed by him in his April 30th telegrams." (Appendix A, *infra*, pp. 14-15)

Thus the Court of Appeals not only ignored the fact that the S. E. C. made no further objection, after the April 30th telegram was filed and amended, but used petitioner's resort to his constitutional guarantee of due process of law to determine the Swiss banks' right to vote, to "negative" his contention that he "had 'righted' any wrongs committed by him in his April 30th telegrams." In doing so it misstated, unintentionally we are sure, that May 9th, 1958 was "the day the 'withdrawal' telegrams were sent," and that this "was Friday." The telegrams were sent on May 8th (Printed record, Nos. 12,742-12,745, Appel-

lee's Appendix, p. 41b), a Thursday. Thus there were practically 5 full days intervening before the polls were closed at 4:03 P.M. on May 13, 1958. (Exhibit P-26).

The 2 Swiss banks have total resources in Swiss francs equal to 1 billion 600 million American dollars. Petitioner owned 500 shares, or $6,000 worth of stock. Yet the 2 banks were unwilling to vote their 700,000 shares of unowned and unrestricted stock and defend their right to vote in an American court.

The April 30 telegram was a permissible statement of American law and practice and within the limits of advocacy.

It has been petitioners' undeviating position that the statements in the telegram were entirely proper. Thus he cited to the Court the following authorities, *none of which are referred to in either court's opinion;* and all of which show that under American law and practice it is improper for a mere nominee, without ownership in the stock or any authorization to vote it, to execute proxies therefor:

> Senate Report No. 1455, 73rd Congress, 2d session, with respect to the Congressional intent in enacting the proxy section of the Securities Exchange Act.[1]
>
> Rule 452 (formerly 872) of the New York Stock Exchange.[2]

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[1] "The rules and regulations (of the S. E. C.) will also render it impossible for brokers having no beneficial interests in a security to usurp the franchise power of their customers and thereby deprive the latter of their voice in the control of the corporations in which they hold securities." Senate Report No. 1455, *supra*, at p. 77

[2] "A member firm * * * which has not received instructions from the beneficial owner by the date specified in the statement accompanying such material, may give a proxy to vote such stock, provided the person signing the proxy has no knowledge of any contest * * *." 2 CCH *New York Stock Exchange Guide*, Par. 2452.

The Business Lawyer, Nov. 1955, pp. 104, 105, 106.[3]

The testimony of then S. E. C. Chairman Armstrong before a subcommittee of the Senate Banking and Currency Committee on March 5, 1957.[4]

Title 15 Purdon's Pa. Statutes §§ 104, 105 and 110, which in terms permit only the beneficial owner to vote stock and prohibit a nominee's voting in a contested election of a Pennsylvania railroad or public utility corporation. (See Appendix C, *infra*, for text of said statutes).

Scott on *Trusts* (1956 edition) to the effect that "In Pennsylvania it is provided by statute that a passive trustee cannot vote stock, but it is to be voted by the real owner. See *Coolbaugh* v. *Herman*, 221 Pa. 496 * * *. § 193.1 at p. 1460." Scott cites this in his 1956 edition, thereby refuting respondents'

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[3] * * *. Although a nominee is not subject to the rules of the New York Stock Exchange, the authority of its principal is nevertheless usually limited by some collateral instrument in so far as the giving of proxies is concerned. Take, for example, the nominee of a bank holding 10,000 shares of record. * * * Out of these 10,000 shares the bank may have the unrestricted right to vote 5,000 shares, *either as sole trustee or as an unrestricted agent*. As to 2,000 shares it must get the consent of a co-trustee, and as to 3,000 shares it must get a positive direction from the beneficial owner. (Our emphasis).

"Many nominees followed the practice of sending a beneficial owner of, for example, 100 shares, one executed proxy so limited in favor of management and another executed proxy so limited in favor of the Wolfson Committee, with instructions to the beneficial owner to send in the proxy of his choice and destroy the other."

"*The Work of the Inspectors of Election in the Montgomery Ward Proxy Contest*," in The Business Lawyer, November 1955, pp. 104, 105, 106.

[4] See "S. E. C. Enforcement Problems", Hearing, U. S. Senate Subcommittee on Banking & Currency, 85th Cong., 1st Sess., March 5, 1957, p. 47.

contention that the statute was repealed by implication in 1954 by enactment of the Pennsylvania Uniform Commercial Code, Sec. 8-207, 12A P. S. That section refers to the issuer's rights *vis-a-vis* a registered owner, and not to the rights of an "actual stockholder" *vis-a-vis* a nominee as does 45 P. S. § 104, and 110.

The decisional law of the Supreme Court of the State of Pennsylvania.[5]

REASONS FOR GRANTING THE WRIT

I. The Court of Appeals has applied the "unclean hands" maxim in conflict with the limitations and rules established by the decisional law of this Court.

A. The conflict with this Court's rule limiting application of the maxim to acts of "unconscionable" and "corrupt" intent.

Some 23,000 small stockholders of The Pennsylvania Railroad Company and their candidate have been deprived of access to the Court of Appeals for determination of their *legal* and *equitable* rights and remedies under the State Constitution and Federal and State statutes by the application of the "unclean hands" maxim where no facts showing "unconscionable" conduct and "corrupt" intent were pleaded, tried, or found.

That such conduct and intent are indispensable elements of the "unclean hands" maxim has repeatedly been made clear by this Court. "* * * courts of equity do not make the quality of suitors the test. They apply the maxim requiring clean hands *only* where some unconscionable act

[5] "The right of voting stock is inseparable from the right of ownership. The one follows as a sequence from the other, and the right to vote cannot be separated from the ownership, without the consent of the legal owner." *Tunis* v. *Hestonville, Mantua & Fairmount Pass. R. R. Co.*, 149 Pa. 70, 85; also see *Coalbaugh* v. *Herman*, supra, and *Commonwealth* v. *Roydhouse*, 233 Pa. 234.

of one coming into relief has immediate and necessary relation to the equity that he seeks in respect of the matter in litigation." *Keystone Driller Co.* v. *General Excavator Co.*, 290 U. S. 240, 245. (Emphasis supplied) "Defendant's contention that corrupt intent is immaterial cannot be sustained in the light not only of the *Keystone* opinion and the cases cited therein, but of a host of other decisions. (citing 7 cases)." *Goodyear Tire & Rubber Co.* v. *Overman Cushion Co.*, 95 F. 2d 978, 982 (6 Cir.). Thus this Court has applied the maxim where the parties were "steeped in perjury", *Precision Instrument Mfg. Co.* v. *Automotive Maintenance Machinery Co.*, 324 U. S. 806; or where there was "a deliberately planned and carefully executed scheme to defraud not only the Patent Office but the Circuit Court of Appeals," *Hazel-Atlas Co.* v. *Hartford Empire Co.*, 322 U. S. 238; or concealment of evidence and procurement of a false affidavit. *Keystone* case, *supra*, and similar unmistakable cases of unconscionable conduct and corrupt intent.

This Court on the other hand refused to apply the maxim in *Kiefer Stewart Co.* v. *Joseph E. Seagram*, 340 U. S. 211, 214; *Toomer* v. *Witsell*, 334 U. S. 385, 393; *Johnson* v. *Yellow Cab Co.*, 321 U. S. 383; *Manufacturers Finance Co.* v. *McKey*, 294 U. S. 442, 449, 450; and *Loughran* v. *Loughran*, 292 U. S. 216, 228, among others. In the *Loughran* case, the Court said: "By the long line of cases following *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540, it is settled that illegality constitutes no defense when merely collateral to the cause of action sued on. A 'person does not become an outlaw and lose all rights by doing an illegal act.' *National Bank & Loan Co.* v. *Petrie*, 189 U. S. 423, 425."

At the most the Court of Appeals' decision boils down to the fact that there was an 8-day delay in filing under an S. E. C. proxy rule; that the challenged misrepresentations were withdrawn 5 days before the election immediately upon S. E. C. notification; and that petitioner thereafter without further objection by the S. E. C. relied on his

legal rights and remedies in a court of the United States. Certainly these are not Acts of "unconscionable" and "corrupt" intent, despite the perfervid language of "deliberate and malicious" violation and "wrong-doing," with "intent" to "intimidate" 2 Swiss banks whose total resources in Swiss francs are equal to one billion 600 million American dollars.* Obviously banks with such resources and distinguished American counsel are not "intimidated" by a "false and misleading" representation of the law, but by the law itself. "It is not an actionable wrong for one in good faith to make plain to whomsoever he will that it is his purpose to insist upon what he believes to be his legal rights, even though he may misconceive what those rights are." *Kaplan* v. *Helenhart Novelty Corp.*, 2 Cir., 182 F. 2d 311, 314.

The Courts of Appeals have invariably followed this limitation of the maxim to acts of "unconscionable" and "corrupt" intent in all the other cases cited by the decision herein. Thus there was payment of money to an attorney, not for legal services, but for his influence with a then judge of the Court of Appeals. (*Root Refining Co.* v. *Universal Oil Products Co.*, 3 Cir., 169 F. 2d 514); or actual fraud in conveyance of trust property with purpose to defraud other claimants. (*Bishop* v. *Bishop*, 3 Cir. 257 F. 2d 495); or instituting suits found to be in bad faith and without probable cause in order to establish a monopoly. (*Hall* v. *Wright*, 9 Cir., 240 F. 2d 787, 795); or suppressing competition and using patents to create a monopoly. (*Frank Adam Electric Co.* v. *Westinghouse Electric & Mfg. Co.*, 146 F. 2d 165, 8 Cir.) (*Art Metal Works* v. *Abraham & Straus*, 70 F. 2d 641, 2 Cir.).

None of the acts herein are remotely within the scope of the cases cited below.

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* The 2 Swiss banks' resources total more than 7 billion Swiss francs. See Rand McNally, International Bankers Directory, Final 1958 edition, pp. F 457, F 472. At current exchange rates there are 4.37 Swiss francs to the dollar. (N. Y. Times, Nov. 25, 1958, p. 51).

B. The violation of this Court's rule limiting application of the maxim to the "cause of action" and "the very transaction as to which he seeks legal redress."

By agreement of the District Court and all parties the only cause of action (Count V, Civil Action No. 24654) mentioning the Swiss banks stock and requesting any relief with respect thereto was dismissed by consent (Appendix A, p. 5). Thus there was no basis for application of the "unclean hands" defense, since it only applies to "any willful act concerning *the cause of action* which rightfully can be said to transgress equitable standards of conduct." *Precision* case, 324 U. S. at 815. "The court's aid is denied *only* when he who seeks it has violated the law in connection with *the very transaction* as to which he seeks legal redress." (Emphasis supplied). *Olmstead* v. *U. S.*, 277 U. S. 438, 485. Also see *Toomer* v. *Witsell*, 334 U. S. at 393; *Kiefer-Stewart*, supra, 340 U. S. at 214; and *Yellow Cab Co.*, supra, 321 U. S. at 387.

C. The violation of the Federal Rules of Civil Procedure Nos. 8, 9(b), and 15(b) promulgated by this Court, since none of the findings of fact and conclusions of law constituting the "unclean hands" ruling was pleaded nor tried by consent, including the crucial finding that the acts were "deliberate and malicious" violations of the S. E. C. rules, and defendants never amended their pleadings to include any of these facts or conclusions.

We invite respondents to quote to the Court any pleading in which they mentioned (1) the Swiss banks; (2) the telegrams to those banks; (3) the S. E. C. rules found violated by the 8-day delay in filing the telegrams; (4) the misrepresentations of the law made in the telegrams; (5) the sender's "malice" and "intent"; and (6) the theory of the defense, namely "unclean hands".

F. R. C. P. 8, 9(b), and 15(b) preclude such a lack of notice, which made it impossible for plaintiffs to resort to pre-trial discovery or to ascertain whether the Swiss banks in fact were influenced by incorrect representations in the telegram or abstained from voting other persons' stock for other reasons.

D. The extension of the maxim to bar legal rights and remedies in violation of this Court's rule limiting its application to equitable rights and remedies.

This Court unanimously ruled in *Manufacturers Finance Co.* v. *McKey*, 294 U. S. 442:

> "That court denied all further relief on the sole ground that petitioner's demand was inequitable and that in making it petitioner had not come into equity with clean hands. * * *
>
> "* * * The petitioner here did not seek equitable relief. It sought an enforcement of its legal rights; and, as said by the Supreme Court of Pennsylvania, '*Legal rights are as safe in chancery as they are in a court of law, and however strong an appeal may be to the conscience of a chancellor for equitable relief, he is powerless to grant it if the one from whom it must come will be deprived of a legal right.*' Colonial Trust Co. *v.* Central Trust Co., 243 Pa. 268, 276. * * *
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> "* * * We think it a satisfactory reply to such a proposition that the complainants in the present case were not seeking equity, *but to avail themselves of a substantive right under the statutory law of the State*." (294 U. S. at 446, 449, 450, emphasis supplied.)*

And with respect to Constitutional rights this Court has also unanimously ruled:

> "The District Court held that this previous misconduct, not having any relation to the constitutionality of the challenged statutes, did not call for application of the clean hands maxim. We agree." (*Toomer* v. *Witsell*, 334 U. S. 385, 393).

And the Supreme Court of the State of Pennsylvania has also unanimously ruled in an unbroken line of cases that equity has no power to interfere with the statutory

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* The ruling herein was reaffirmed in *Houghton* v. *Restland*, 343 Pa. 625, 635. "Equity is powerless to aid in circumstances of this character where to do so would deprive appellee of a legal right." *First National Bank & Trust Co.* v. *Jaffe*, 322 Pa. 144, 146.

right (12 Purdon's Pa. Statutes, §§ 2022-III; 2040) to the remedy of quo warranto.

> "*It can not be disputed that a court of equity has no jurisdiction in a case of contested right to the possession of a public office. The remedy in such a case is exclusively by quo warranto. This rule applies where the title of an officer of a corporation is contested and that is the real question in this case.* (citing cases) Although the determination of the validity of a corporate election is but incidental to a substantive complaint of which equity has jurisdiction, yet it may have power to pass upon the validity of the election: Deal *v.* Miller, 245 Pa. 1. Here one of the substantive questions involved, *indeed almost the controlling one*, is defendants' right to occupy the offices they hold. *Equity has no power to remove an officer of a private corporation.* Whyte *v.* Faust, 281 Pa. 444.
>
> "• • • A court of equity cannot acquire *and retain jurisdiction* of matters not justiciable before it, such as the removal of corporate officers or the direction of corporate election, through the medium of another matter pleaded within its cognizance but to as which after hearing it does not act and grants no relief: Ahl's App., 129 Pa. 49, 61, 62."
>
> *Cella et al.* v. *Davidson et al.*, 304 Pa. 389, 394, 395, emphasis supplied.
>
> "This specific remedy at law (quo warranto) ousts the equitable jurisdiction of the case."
>
> *Updegraff et al.* v. *Crans*, 47 Pa. 103, 106.
>
> "A proceeding in quo warranto, save as noted above (i.e., in Tennessee), is one at law and of a special and summary character."
>
> Fletcher's *Cyclopedia on Private Corporations*, Vol. 5 § 2327, p. 1026 (1952 ed.).
>
> "Quo warranto will lie to oust corporate officers (citing cases), and as a general rule, where there is an adequate remedy by quo warranto, equity has no jurisdiction, in the absence of statute, to determine the title to an office (citing cases)."
>
> *Id.*, § 2337, p. 1058.

II. The Court of Appeals decision conflicts with Erie v. Tompkins, 304 U. S. 64 as applied in Ragan v. Merchants Transfer & Warehouse Co., 337 U. S. 530, 533.

With respect to the 4 causes of action in the 2 complaints based solely on diversity and alleged violation of State Constitutional and Statutory rights the Court of Appeals *sub silentio* permitted application of the equitable defense of "unclean hands" when both the statutory law and the decisional law of the Supreme Court of Pennsylvania is unremitting in providing that such a defense is not available to bar legal rights and "it is well settled that equity has no inherent jurisdiction to determine the right to a corporate office or the validity of a corporate election." *Bedford Springs Co.* v. *McMeen*, 161 Pa. 639, and *Cella* v. *Davidson*, 304 Pa. 389, among others as cited in *Johnson* v. *Horton*, 9 Cir., 63 F. 2d 950, 952, 953.

Thus the *Erie* rule as applied in *Ragan* is directly violated here:

> "Since that cause of action is created by local law, the measure of it is to be found only in local law. It carries the same burden *and is subject to the same defenses in the federal court as in the state court.* See *Cities Service Co.* v. *Dunlap*, 308 U. S. 208; *Palmer* v. *Hoffman*, 318 U. S. 109, 117. * * * Where local law qualifies or abridges it, the federal court must follow suit. Otherwise there is a different measure of the cause of action in one court than in the other, and the principle of *Erie R. Co.* v. *Tompkins* is transgressed." (337 U. S. at 533). (Emphasis supplied).

See quotations under point I (D) above, of the decisional law of the Supreme Court of Pennsylvania; and from the *Manufacturers Finance* case, 294 U. S. at 449, 450.

III. The retroactive application of the "unclean hands" bar to appeal No. 12,618, and its application to innocent petitioners therein and in No. 12,744 constitutes an unprecedented denial of their constitutional right to due process of law to enforce their substantive rights under the State Constitution and the Federal and State statutes, none of which can constitutionally be made dependent upon the acts of another person.

We believe this proposition too self-evident to need argument.

IV. The Court of Appeals upholding of the constitutionality of the State security for costs statute in the derivative suit conflicts with this Court's rule that such constitutional attacks should first be determined in the State courts.

The Court's latest decision in this respect is *Harrison* v. *N. A. A. C. P.*, 359 U. S. 167, 176, 177, citing cases. We believe there is no necessity to argue this point further, other than to note that plaintiffs to escape security for costs would have had to hold 5% or $7,900,000 in market value of the total stock of The Pennsylvania Railroad Company. Thus the Pennsylvania statute (12 Purdon's Pa. Statutes, §§ 1322-1323; see Appendix D. hereafter), in requiring holdings of 5% of the stock and omitting the option of holding only $50,000 worth as provided in the similar New York and New Jersey statutes, is susceptible of serious attack as a denial of the constitutional right to equal protection under the law. This Court in *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U. S. 541 upheld the constitutionality of a New Jersey statute that included the 5% or $50,000 option. It has never approved a statute that omitted the option.

CONCLUSION

The decision in the Court of Appeals (Nos. 12,618; 12,744; and 12,745) we believe is summarily reversible without need for further briefing or oral argument, since if the "unclean hands" maxim has been erroneously applied on the authority of the cases cited herein no further argument is needed to illuminate the point. Inasmuch as a 4-year term of office, expiring 1962, is at stake, on which the time has already run for 18 months, expedition would serve justice and be in the interest of the 23,000 stockholders who voted for the minority candidate to represent them on the board of directors.

Similarly, the sole issue on appeal in the derivative action (No. 12,759) seems to have been clearly and unremittingly determined by this Court in the *Harrison* v. *N. A. A. C. P.* case, 359 U. S. 167 and the prior cases cited therein at 176-177.

For the above reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

JOSEPH B. HYMAN,
Attorney for Petitioners
216 Prince Street
Alexandria, Va.

October 2, 1959.

APPENDIX.

APPENDIX A

(OPINION OF THE COURT OF APPEALS)

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,618

LOUIS GAUDIOSI, CHARLES SCHWARTZ, AND RANDOLPH PHILLIPS, INDIVIDUALLY AND ON BEHALF OF ALL OTHER STOCKHOLDERS OF THE PENNSYLVANIA RAILROAD COMPANY SIMILARLY SITUATED,

Appellants

v.

RICHARD K. MELLON, ROBERT T. McCRACKEN, C. JARED INGERSOLL, WALTER S. FRANKLIN, JAMES E. GOWEN, PHILIP R. CLARKE, JAMES M. SYMES, JOHN A. DIEMAND, JOHN B. HOLLISTER, LAMMOT DUP. COPELAND, DONALD DANFORTH, R. GEORGE RINCLIFFE, WILLIAM L. DAY, OTTO N. FRENZEL, FRED CARPI, DAVID C. BEVAN, JAMES P. NEWELL, DIRECTORS

and

THE PENNSYLVANIA RAILROAD COMPANY, A CORPORATION, INCORPORATED UNDER THE LAWS OF THE COMMONWEALTH OF PENNSYLVANIA,

Appellees

Nos. 12,742; 12,743; 12,744; 12,745

LOUIS GAUDIOSI, CHARLES SCHWARTZ AND RANDOLPH PHILLIPS, INDIVIDUALLY AND ON BEHALF OF ALL OTHER STOCKHOLDERS OF THE PENNSYLVANIA RAILROAD COMPANY SIMILARLY SITUATED,

Appellants

v.

WALTER S. FRANKLIN, RICHARD K. MELLON, ROBERT T. McCRACKEN, C. JARED INGERSOLL, JAMES E. GOWEN, PHILIP R. CLARKE, JAMES M. SYMES, JOHN A. DIEMAND, JOHN B. HOLLISTER, LAMMOT DuP. COPELAND, DONALD DANFORTH, R. GEORGE RINCLIFFE, WILLIAM L. DAY, OTTO N. FRENZEL, FRED CARPI, DAVID C. BEVAN, JAMES P. NEWELL, DIRECTORS: BAYARD H. ROBERTS

and

THE PENNSYLVANIA RAILROAD COMPANY, a CORPORATION INCORPORATED UNDER THE LAWS OF THE COMMONWEALTH OF PENNSYLVANIA,

Appellees

No. 12,759

LOUIS GAUDIOSI, CHARLES SCHWARTZ, AND RANDOLPH PHILLIPS, INDIVIDUALLY AND ON BEHALF OF ALL OTHER STOCKHOLDERS OF THE PENNSYLVANIA RAILROAD COMPANY SIMILARLY SITUATED,

Appellants

v.

WALTER S. FRANKLIN, RICHARD K. MELLON, ROBERT T. McCRACKEN, C. JARED INGERSOLL, JAMES E. GOWEN, PHILIP R. CLARKE, JAMES M. SYMES, JOHN A. DIEMAND, JOHN B. HOLLISTER, LAMMOT DU P. COPELAND, DONALD DANFORTH, R. GEORGE RINCLIFFE, WILLIAM L. DAY, OTTO N. FRENZEL, FRED CARPI, DAVID C. BEVAN, JAMES P. NEWELL, DIRECTORS: BAYARD H. ROBERTS

and

THE PENNSYLVANIA RAILROAD COMPANY, A CORPORATION INCORPORATED UNDER THE LAWS OF THE COMMONWEALTH OF PENNSYLVANIA,

Appellees

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued January 19, 1959

Before KALODNER and HASTIE, *Circuit Judges* and EGAN, *District Judge*

OPINION OF THE COURT

(Filed June 24, 1959)

By KALODNER, *Circuit Judge*

Two separate actions in the United States District Court for the Eastern District of Pennsylvania, arising out of a proxy contest for the election of six directors of the Pennsylvania Railroad Company ("Railroad") at its annual meeting on May 13, 1958, resulted in the six appeals now to be considered.

The first of the two actions (No. 24,456 below), was filed April 9, 1958, by Randolph Phillips, Louis Gaudiosi and Charles Schwartz,[1] citizens of New York, individually and in behalf of stockholders, against the Pennsylvania Railroad Company ("Railroad"), a Pennsylvania corporation having its principal office in Philadelphia, Pennsylvania, and its Directors, all citizens of states other than New York.

The complaint in this first action alleged multiple claims in four counts premised upon events which had occurred up until its filing in the campaign conducted for proxies by plaintiffs in behalf of Phillips' candidacy for director, and the Railroad for its six nominees.

It sought a declaratory judgment invalidating all proxies received by Railroad, an injunction against Railroad's solicitation of proxies in the manner pursued prior to the filing of the action and the use of Railroad's funds in solicitation of proxies, and a mandatory order that Railroad supply all stockholders with a ballot form of proxy and statement by Phillips refuting alleged false and misleading statements made by Railroad in letters earlier sent to stockholders.

On May 6, 1958, the Court below, following hearings, entered an Order[2] denying the relief sought by the plaintiffs, dismissing their complaint and entering judgment for the defendants with costs. Plaintiffs' appeal No. 12,618 arises out of the May 6, 1958 Order.

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1 Phillips, Gaudiosi and Schwartz at the time of the filing of the first action were beneficial owners respectively of 500, 1,400 and 500 shares of the common stock of the Pennsylvania Railroad Company.

2 Findings of Fact and Conclusions of Law by the District Court accompanied its Order of May 6, 1958. They are unreported.

The second of the two actions (No. 24,654 below) was filed on May 9, 1958, by the plaintiffs against the defendants named in the first action and Bayard H. Roberts, secretary of Railroad. It, too, related to the proxy contest. It sought a declaratory judgment invalidating all proxies received by Railroad in support of its nominees, an injunction restraining Railroad's use of the proxies at the annual meeting at which six directors were to be elected, and postponement of the annual election until at least three weeks after the entry of a final order disposing of plaintiffs' request for relief.

In Count IV of their complaint plaintiffs pleaded a class action and asserted a derivative claim that the defendant directors were liable to Railroad for improper expenditures of corporate funds to promote the candidacies of management's six nominees for director, and sought an order requiring payment by the individual directors of all expenditures by Railroad in the proxy contest.

After filing this second complaint on May 9, 1958, plaintiffs, the same day, sought to amend it by adding as defendants Swiss banks which allegedly had 707,734 shares of common stock of Railroad registered in their names. In this fifth count plaintiffs sought an injunction restraining the Swiss banks from voting the stock mentioned at the May 13, 1958 annual election or executing proxies in favor of management nominees for directors. Copies of the amended complaint were served upon the Swiss banks on May 12, 1958. Subsequently, on June 10, 1958, this fifth count was dismissed on motions of the Swiss banks, by stipulation of the parties.

A hearing on plaintiff's motion for preliminary injunction scheduled to take place on May 13, 1958, the date of the election, was continued until May 19, 1958, and the annual election proceeded without restraint.

On May 19, 1958, upon agreement of the parties, the hearing was postponed until the judges of election had filed their report. On June 4, 1958, after the report had been filed, another hearing was held and the Court below entered

a temporary restraining order serving to enjoin the management nominees from taking office pending disposition of the proceedings after final hearings which were concluded in July, 1958.

On August 5, 1958, the Court below entered an Order directing rehearing upon the class action claims embodied in Count IV of plaintiffs' complaint and for a separate trial of the claims. In an Opinion [3] accompanying the Order the Court below stated (p. 352) ". . . the plaintiffs have presented the representative claim in such haphazard fashion as to make it virtually impossible for the trial judge to make any just, proper determination."

On August 6, 1958, the Court below, pursuant to defendants' motion for an order requiring plaintiffs to furnish security for expenses, including attorneys' fees, incurred in connection with the proceedings relating to the class action claims in Count IV, entered an Order [4] directing plaintiffs to give such security in the sum of $3,000 on or before September 17, 1958. The Order directed the Clerk of the Court to mark the representative claim in the class action in Count IV dismissed in the event of failure to file the security specified. Developments with respect to this phase of the action will be discussed later.

On August 18, 1958, the Court below, complying with Rule 54(b), Federal Rules of Civil Procedure, entered final judgment for the defendants on all of the several claims in plaintiffs' second action, except with respect to the class action claims in Count IV, reserved for trial in its prior order of August 5, 1958.[5] Unquestionably this judgment was immediately appealable.

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3 Gaudiosi v. Franklin, 166 F. Supp. 351 (E.D. Pa. 1958).

4 In its "Memorandum Re Security for Expenses", unreported, the Court below noted that the Pennsylvania Statute, 12 P.S. §§ 1321-1323 required security in any suit instituted by the holders of less than 5% of the outstanding shares of any class of a corporation's stock, and that the plaintiffs owned only approximately .00018 per cent of the Pennsylvania Railroad Company's stock.

5 The District Court's Findings of Fact and Conclusions of Law, accompanying its Order of August 18, 1958, are reported at 166 F. Supp. 353 (E.D. Pa. 1958). The Order vacated an outstanding restraining order (dated June 4, 1958), denied all of plaintiffs' claims for relief except with respect to the class action claims in Count IV and directed entry of judgment, with costs, in favor of defendants, on all issues except with respect to the class action claims.

However, on August 27, 1958, plaintiffs filed a motion, on its face denominated a motion pursuant to Rule 52(b), to amend particular findings of fact. The motion recited plaintiffs' desire to introduce new evidence on the particular factual issue and tendered supporting matter in the nature of new documentary evidence. Then, on September 16, 1958, with this motion pending before the Court below, the plaintiffs filed notices of appeal from the August 18th judgment which were subsequently docketed and are now before us as No. 12,742 and No. 12,743.

But a timely post judgment motion under Rule 52(b) deprives the judgment, for the time being at least, of its finality, and its immediate appealability. United States v. Crescent Amusement Co., 323 U.S. 173 (1944) cert. den. 323 U.S. 818; cf. Continental Oil Co. v. United States, 299 U.S. 510 (1936); Aberlin v. Zisman, 244 F.2d 620 (1st Cir. 1957) cert. den. 355 U.S. 857. As this Court stated in Healy v. Pennsylvania R. Co., 181 F.2d 934, 935 (1950):

> "The District Court when timely substantive motions are entertained and pending, has not lost jurisdiction, and it having the power to grant the motions, the judgment is not final for the purposes of appeal."

If this were all, the prematurity of the appeals at No. 12,742 and No. 12,743 would be clear. However, on September 29, 1948, the Court below denied the motion to amend its findings, ruling that it had no authority under that rule to make an amendment which could be justified only by matter outside the trial record. It is now argued that the motion was not in legal contemplation or effect a 52(b) motion and, therefore, that it did not affect the finality or appealability of the judgment. However, Rule 52(b) explicitly authorizes motions "not later than 10 days after entry of judgment . . . [to] amend its findings or make additional findings . . ." The instant motion was filed nine days after entry of judgment and it plainly asked for an amend-

ment of the court's findings. It was in fact and law a timely motion under Rule 52(b). It is true that the Court below found the motion without proper basis because it was predicated upon matter dehors the record.[6] But the pleading was still a request for relief under Rule 52(b) and as such it suspended the appealability of the judgment until September 27, 1958, when the motion was denied.

Thereafter, on October 9, 1958, appeals were again taken from the original judgment at No. 12,744 and No. 12,745. These were timely and proper. Under Rule 73(a) "the full time for appeal [30 days] . . . commences to run and is to be computed from the entry of [an] order . . . denying a [timely] motion under Rule 52(b) to amend or make additional findings of fact." Here appeals were taken within two weeks after denial of the timely motion for relief under Rule 52(b). There is no substance to defendants' argument that the invalid appeal taken while the Rule 52(b) motion was pending below, nevertheless incapacitated the trial court from disposing of that pending motion. The premature appeal was legally a nullity. United States v. Crescent Amusement Co., supra at 177-178.

It follows that the appeals at No. 12,742 and No. 12,743 must be dismissed as premature and ineffectual. The appeals at No. 12,744 and No. 12,745 are entitled to consideration on their merits.

Before such consideration is given, the case history of still another of these appeals, No. 12,759, must be stated. This appeal relates to that facet of this complex litigation

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6 The brief Memorandum supporting the denial of the motion stated:

". . . An examination of the motion discloses that the request to amend finding of fact No. 9 is not predicated upon the trial record upon which the adjudication filed August 18, 1958 was founded. Instead the present motion requests the court to consider as evidence certain exhibits attached to the motion which were never identified or offered in evidence during the trial and form no part of the trial record. The obvious purport of the motion is to request the court to permit bills which were never a part of the trial record to be offered ex parte by this plaintiff long after the trial was concluded and subsequent to the adjudication by the court. As we view it the end sought by the present motion is not properly within the scope of Rule 52(b)."

concerned with the class action claims in Count IV and the District Court's Order of August 6, 1958 directing plaintiffs' giving of security for expenses, including attorneys' costs, earlier recited. The August 6th Order directed the Clerk of the Court to dismiss the Count IV class action unless the security was entered on or before September 17, 1958. It appears that on August 27, 1958 plaintiffs served interrogatories on Railroad purporting to relate to the class action claims. On September 5, 1958, Railroad filed objections to the interrogatories, one of which was premised on the ground that the interrogatories were premature since plaintiffs had not complied with the Order of August 6, 1958 to post "security for expenses" by September 17, 1958 under penalty of dismissal. In an apparent effort to meet this objection, one of the plaintiffs, Gaudiosi, on September 10, 1958 filed a bond for "costs" in the sum of $3,000. The bond bore the signature of a surety company only.

On October 21, 1958 the Court below held an unreported hearing in chambers on defendants' objections to plaintiffs' interrogatories. Defendants urged that in filing the bond for "costs" only on September 10, 1958 plaintiffs had not complied with the Court's Order of August 6, 1958 which provided "that plaintiffs shall give security in the sum of $3,000 for any reasonable expenses, including attorneys' fees, which may be incurred by The Pennsylvania Railroad Company, . . ." The Court below subscribed to defendants' contention in this respect and later in the day entered an Order sustaining their objections to the interrogatories "because of plaintiffs' non-compliance with the order of this Court dated August 6, 1958."

The next day—October 22, 1958—the Clerk of the District Court, pursuant to defendants' praecipe filed that day, dismissed the representative claim in the class action in Count IV, "for failure of plaintiffs to comply with said order [August 6, 1958] of the Court." Plaintiffs appealed from this dismissal on October 28, 1958—Appeal No. 12,759.

The foregoing brings us to consideration of the appeals which require disposition, namely, Appeal No. 12,618—from the dismissal of plaintiffs' first action on May 8, 1958; Appeals No. 12,744 and 12,745—from the entry of judgment for defendants on August 18, 1958 in plaintiffs' second action, and Appeal No. 12,759—from the dismissal on October 22, 1958 of the class action claim in Count IV.

We shall first consider Appeal No. 12,759.

With respect to that appeal plaintiffs make three main contentions: (1) the District Court (via its clerk) had no jurisdiction on October 22, 1958 to dismiss the class action claim in Count IV because its Order of August 18, 1958, reserving for trial that claim—in accordance with its prior Order of August 5, 1958—had been earlier appealed; (2) the Pennsylvania statute requiring security for costs is unconstitutional, and (3) the District Court abused its discretion in (a) erroneously delaying final judgment on the class action claim in Count IV in its Orders of August 5th and 18, 1958; (b) unreasonably fixing $3,000 "security for expenses" in its Order of August 6, 1958, and (c) ruling the bond posted for "costs" as non-compliance with the August 6, 1958 Order.

Plaintiffs' contentions can be described as nothing less than specious. As to the first—the record discloses that the District Court exercised sound discretion when in compliance with Rule 54(b) it directed final judgment on all issues in plaintiffs' second action and reserved for further trial the class action claim in Count IV. By reason of that reservation there was no final appealable judgment as to it, and, it was not within the periphery of Appeals No. 12,744 and No. 12,745.

Plaintiffs' contention that the Pennsylvania statute providing for security for expenses in derivative actions is unconstitutional ignores our implicit holding to the contrary in Knapp v. Bankers' Securities Corporation, 230 F.2d 717 (1956) and Murdock v. Follansbee Steel Corp., 213 F.2d 570 (1954).

Finally, we can discern no possible basis for holding that the District Court abused its discretion in fixing $3,000 "security for expenses" in its Order of August 6, 1958 or in ruling, in its Order of October 21, 1958, that the $3,000 "costs" bond filed by Gaudiosi—one of the plaintiffs—was not in compliance with the August 6, 1958 Order to file "security for expenses".

For the reasons stated the Order of October 22, 1958 dismissing the class action claim in Count IV will be affirmed in Appeal No. 12,759.

For reasons later stated, we will consider together the remaining appeals—No. 12,618 from dismissal of plaintiffs' first action on May 6, 1958 and Nos. 12,744-45 from entry of judgment for defendants on August 18, 1958, in plaintiffs' second action.

Both actions sought equitable relief in the proxy contest for the office of director of Railroad, in which plaintiffs sought to break Railroad management's slate of six nominees by electing Phillips. The specific relief sought by plaintiffs in the two actions was earlier stated. Broadly stated, in each, plaintiffs assailed as illegal and inequitable defendants' conduct in the proxy contest and sought to invalidate management proxies received and later cast in support of its six nominees at the May 13, 1958 annual meeting. Further, in both actions, plaintiffs complained that defendants had unlawfully denied rights which allegedly inured to them in the proxy contest, and sought injunctions to enforce them.

The District Court's opinion in the second action, reported at 166 F. Supp. 353 (E.D. Pa. 1958) contains a detailed recital, in its Findings of Fact, of the complex sequence of events in the proxy contest on which plaintiffs sought to premise both of their actions.

In its Findings of Fact, some ultimate in nature, the District Court found that the defendants had not, in any respect, in their conduct of the proxy contest, either committed the unlawful and inequitable acts alleged by the

plaintiffs or denied to them their legal and equitable rights, and that, on the other hand, Phillips had "deliberately and maliciously" in violation of the applicable rules of the Securities and Exchange Commission, in the course of the proxy contest, sought to "intimidate" registered owners of some 800,000 shares of Pennsylvania Railroad Company stock to the end that they would not execute management proxies or vote their stock for management nominees.[7] Based on these fact-findings, the District Court, in paragraph 26 of its Conclusions of Law, ruled that "In this action Phillips came into equity with unclean hands", and in paragraph 27, that "Phillips' unclean hands bar the grant to Phillips of any equitable relief."

On review of the record we are of the opinion that it amply sustains the District Court's fact-findings and Conclusions of Law with respect to Phillips' "unclean hands" and that its Order of August 18, 1958, entering judgment for defendants, except as to the representative claim in the class action embodied in Count IV of their second action, should be affirmed.

It appears that during the proxy contest the New York Times published a news account stating, in substance, that the Swiss Bankers Association had urged its member banks to vote in favor of management whenever they voted proxies on behalf of stockholders in American corporations and that Phillips had knowledge of this account prior to April 30, 1958.

It further appears that on April 30, 1958, Credit Suisse, a Swiss bank, was the registered owner of 362,156 shares of Railroad stock and that the Swiss Bank Corporation, another Swiss bank, was the registered owner of 444,657 shares of the same stock. At the time mentioned Phillips was of the belief that the two Swiss banks were each the registered or beneficial owners of approximately 361,000 shares of Railroad stock, and that they had executed and

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7 Findings of Fact Nos. 52-66, inclusive, 166 F. Supp. 367, 368, 369.

intended to deliver to Railroad proxies to vote in favor of the six management nominees for director.

On April 30, 1958, without prior submission to the Securities and Exchange Commission for "clearance", as required by Rule X-14-A-1, et seq. of the Securities and Exchange Act, Phillips sent to the two Swiss banks identical telegrams as follows:

"I understand that your Bank which is the nominee for 360,918 shares of Pennsylvania Railroad Co. capital stock intends to vote said stock for the 6 management nominees for director at the Railroad's annual election to be held on May 13, 1958, without informing the owners of said stock of the contest for directors now existing and without giving them an opportunity to determine for themselves whether or not their stock should be voted and without giving them an opportunity to vote for myself as the 1 non-management nominee for director, or for the 6 management nominees, or for 5 or less of the management nominees and the 1 non-management nominee. Such arbitrary and undemocratic action by your Bank not only violates American equitable and common law principles applicable to banks when they act as fiduciaries but also violates the rules of the Securities and Exchange Commission and New York Stock Exchange as well as American banking practices applicable to all stock exchange brokers and banks in this country. It is a violation of the concept of a free and fair election on a fully informed basis, it constitutes a fraud upon the stockholders, and can only be of comfort to dictators and totalitarians in or out of corporation management.

"Such action by your Bank also constitutes a combination with the Pennsylvania Railroad management and other company managements that is prohibited under the anti-trust laws of this country and which are

applicable to your Bank since it is doing business in the United States.

"Such improper practices which already have been criticised in the United States Senate threaten to damage immeasurably myself and many thousands of associated stockholders. Unless you give me prompt assurance of the immediate termination of these practices I will reluctantly be compelled to take prompt and appropriate legal action in the courts. Kindly advise me by return wire of your answer to this telegram."

When authorized officials of the Securities and Exchange Commission discovered the transmission of the foregoing telegrams without prior submission to the Commission, they directed Phillips to file copies of them as "soliciting material". Upon his submission of the copies, under protest, on May 9, 1958, the Commission's staff expressed its disapproval and Phillips, either in anticipation of or as a result of it, sent the following telegram to each of the banks:

"I hereby withdraw all statements in my telegram to you dated April 30, 1958 except the first sentence, and I hereby substitute in place of said withdrawn statement the statement that 'If said stock is voted by your Bank I reserve all rights in law and equity to take legal and other appropriate action against you for just and equitable relief' ".

For eight years preceding 1958 the two Swiss banks had sent in their proxies to management for virtually the entire number of shares held by them. However, at the election on May 13, 1958 they together voted approximately only 100,000 shares as to which they had specific instructions from the beneficial owners. They withheld the remaining 700,000 shares, as found by the District Court, as

the direct result of the receipt of Phillips' telegram of April 30, 1958.

That that is so is made manifest by these circumstances: the so-called "withdrawal" telegrams of May 9th specifically contained the threat that if the stock of the Swiss banks was voted for management nominees Phillips reserved "all rights in law and equity to take legal and other appropriate action" against the banks; Phillips the very day that the telegrams were sent filed an amendment to his second complaint by adding the Swiss banks as defendants and copies of the amended complaint were served on the Swiss banks on May 12, 1958; and May 9th, the day the telegrams were sent, was Friday and the week-end intervened between that day and Tuesday, May 13th when the annual meeting took place.

The foregoing negatives Phillips' contention that the telegrams of May 9th had "righted" any wrongs committed by him in his April 30th telegrams.

We do not need to dwell further on the District Court's findings of "unclean hands" on Phillips' part except to say that his dire threats to the Swiss banks in his April 30th telegrams of possible anti-trust action, and his invocation of the spectres of "fraud", "violation of American equitable and common law principles applicable to banks", violation of "the rules of the Securities and Exchange Commission and New York Stock Exchange as well as American banking practices applicable to all stock exchange brokers and banks in this country" amply supported the District Court's fact-finding of "deliberate and malicious" wrongdoing with intent to "intimidate" in violation of the Rules of the Securities and Exchange Commission in proxy contests.

Clearly Phillips' conduct constituted the "unclean hands" which barred his prayers for equitable relief.

The bar of "unclean hands" extends to plaintiffs' first action although it was not there considered in the District Court's disposition of it, and was not raised by defendants.

It will be recalled that plaintiffs' first action was dismissed on May 6, 1958. Phillips' telegrams to the Swiss banks on April 30, 1958 preceded that dismissal. Plaintiffs appeal from that dismissal is before us in Appeal No. 12,618.

These principles are well-settled:

One who comes into equity must come with clean hands and keep those hands clean throughout the pendency of the litigation even to the time of ultimate disposition by an appellate court.[8]

Courts are concerned primarily with their own integrity in the application of the clean hands maxim and even though not raised by the parties the court will of its own motion apply it.[9]

The clean hands maxim gives wide sweep to the equity court's exercise of discretion "in refusing to aid the unclean litigant."[10]

The equity court "is not bound by formula or restrained by any limitation that tends to trammel the free and just exercise of discretion."[11]

The principles stated are dispositive with respect to plaintiff's first and second actions, although, as previously stated, the issue of "unclean hands" was not raised by defendants or considered by the District Court in the first action as it was in the second action. The April 30, 1958 telegrams to the Swiss banks tainted the first action to the same extent that it did the second. The District Court properly exercised its discretion in applying the "unclean hands" maxim in denying relief to plaintiffs in the second action. The fact that it did not invoke the maxim in its

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8 Hazel-Atlas Co. v. Hartford Co., 322 U.S. 238; 250 (1944).

9 Hall v. Wright, 240 F.2d 787, 795 (9th Cir. 1957); Frank Adam Electric Co. v. Westinghouse Elec. & Mfg. Co., 146 F.2d 165, 167 (8th Cir. 1945).

10 Precision Co. v. Automotive Co., 324 U.S. 806, 815 (1945).

11 Keystone Driller Co. v. General Excavator Co., 290 U.S. 240, 245 (1933); Bishop v. Bishop, 257 F.2d 495, 500 (3rd Cir. 1958).

disposition of the first action is immaterial. We can and must do so here under the cases cited.

As we stated in Root R . ing Co. v. Universal Oil Products Co., 169 F.2d 514, 534, 535 (1948), cert. den. 335 U.S. 912, reh. den. 336 U.S. 915:

> ". . . No principle is better settled than the maxim that he who comes into equity must come with clean hands and keep them clean throughout the course of the litigation, and that if he violates this rule, he must be denied all relief whatever may have been the merits of his claim . . ."

Plaintiffs' contention that defendants were not "injured" by reason of the sending of the April 30, 1958 telegrams is irrelevant to the issue. As Judge Learned Hand in his dissenting opinion in Art Metal Works v. Abraham & Straus, 70 F.2d 641 (2d Cir. 1934) cert. den. 293 U.S. 596, so aptly stated (p. 646):

> "The doctrine [of unclean hands] is confessedly derived from the unwillingness of a court, originally and still nominally one of conscience, to give its peculiar relief to a suitor who in the very controversy has so conducted himself as to shock the moral sensibilities of the judge. *It has nothing to do with the rights or liabilities of the parties; indeed the defendant who invokes it need not be damaged, and the court may even raise it sua sponte* . . ." (emphasis supplied)

There remains for disposition Phillips' contention that "the maxim of 'unclean hands' does not dispose of the rights of others", and that "neither plaintiffs Gaudiosi or Schwartz participated in these acts of Phillips, thus the defense is totally inapplicable to them, as well as to the 23,000, or less, stockholders upon whose behalf all three plaintiffs sued."

The contention is utterly without merit. It ignores the earlier cited principle that courts are concerned primarily with their own integrity in the application of the clean hands maxim. Courts in such situations act for their own protection and not as a matter of "defense" to the defendant. Public policy not only makes it obligatory for courts to deny a plaintiff relief once his "unclean hands" are established but to refuse to even hear a case under such circumstances. Thus it has been held that even in a stockholders' derivative action "unclean hands" on the part of a plaintiff will require dismissal of the action.[12]

Apart from the foregoing, to subscribe to this last contention would require us to ignore the fact that plaintiffs' two actions (apart from the derivative claim in Count IV) were specifically instituted to further Phillips' candidacy for director. The startling result would be to permit Phillips to eat his apple with "unclean hands". Justice may be blind but it isn't "dumb".

For the reasons earlier stated the appeals in Nos. 12,742 and 12,743 will be dismissed and the Orders in appeals Nos. 12,618, 12,744, 12,745 and 12,759 will be affirmed.

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12 Rosenfeld v. Zimmer, 116 CA 2d 719, 254 P.2d 137, 139 (Calif. 1953).

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

Appendix B.

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 12,618

Louis Gandiosi, Charles Schwartz and Randolph Phillips, individually and on behalf of all other stockholders of the Pennsylvania Railroad Company similarly situated

vs.

Richard K. Mellon, Robert T. McCracken, C. Jared Ingersoll, Walter S. Franklin, James E. Gowen, Philip R. Clarke, James M. Symes, John A. Diemand, John B. Hollister, Lammot duP. Copeland, Donald Danforth, R. George Rineliffe, William L. Day, Otto N. Frenzel, Fred Carpi, David C. Bevan, James P. Newell, Directors, and The Pennsylvania Railroad Company, a corporation incorporated under the laws of the Commonwealth of Pennsylvania

Louis Gandiosi, Charles Schwartz and Randolph Phillips, Appellants

(District Court No. 24456 Civil)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

PRESENT: KALODNER and HASTIE, Circuit Judges; and EGAN, District Judge.

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of May 6, 1958 of the said District Court in this case be, and the same is hereby affirmed, with costs.

Attest:
IDA O. CRESKOFF
Clerk

June 24, 1959

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 12,744

Louis Gaudiosi, Charles Schwartz and Randolph Phillips, individually and on behalf of all other stockholders of the Pennsylvania Railroad Company similarly situated;

vs.

Walter S. Franklin, Richard K. Mellon, Robert T. McCracken, C. Jared Ingersoll, James E. Gowen, Philip R. Clarke, James M. Symes, John A. Diemand, John B. Hollister, Lammot duP. Copeland, Donald Danforth, R. George Rincliffe, William L. Day, Otto N. Frenzel, Fred Carpi, David C. Bevan, James P. Newell, Directors; Bayard H. Roberts; and The Pennsylvania Railroad Company, a corporation.

Louis Gaudiosi and Charles Schwartz,
Appellants

(District Court No. 24654 Civil)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

PRESENT: KALODNER and HASTIE, Circuit Judges; and EGAN, District Judge.

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the orders of August 18, 1958 and September 29, 1958 of the District Court in this case be, and the same are hereby affirmed, with costs.

Attest:
IDA O. CRESKOFF
Clerk

June 24, 1959

UNITED STATES COURT OF APPEALS

For the Third Circuit

No. 12,745

Louis Gaudiosi, Charles Schwartz and Randolph Phillips, individually and on behalf of all other stockholders of the Pennsylvania Railroad Company similarly situated

vs.

Walter S. Franklin, Richard K. Mellon, Robert T. McCracken, C. Jared Ingersoll, James E. Gowen, Philip R. Clarke, James M. Symes, John A. Diemand, John B. Hollister, Lammot du P. Copeland, Donald Danforth, R. George Rincliffe, William L. Day, Otto N. Frenzel, Fred Carpi, David C. Bevan, James P. Newell, Directors; Bayard H. Roberts; and The Pennsylvania Railroad Company, a corporation.

Randolph Phillips,

Appellants

(District Court No. 24654 Civil)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

Present: Kalodner and Hastie, Circuit Judges; and Egan, District Judge.

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the orders of August 18, 1958 and September 29, 1958 of the District Court in this case be, and the same are hereby affirmed, with costs.

Attest:

Ida O. Creskoff
Clerk

June 24, 1959

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 12,759

Louis Gaudiosi, Charles Schwartz and Randolph Phillips, individually and on behalf of all other stockholders of the Pennsylvania Railroad Company similarly situated:

vs.

Walter S. Franklin, Richard K. Mellon, Robert T. McCracken, C. Jared Ingersoll, James E. Gowen, Philip R. Clarke, James M. Symes, John A. Diemand, John B. Hollister, Lammot duP. Copeland, Donald Danforth, R. George Rincliffe, William L. Day, Otto N. Frenzel, Fred Carpi, David C. Bevan, James P. Newell, Directors; Bayard H. Roberts; and The Pennsylvania Railroad Company, a corporation.

Louis Gaudiosi, Charles Schwartz and Randolph Phillips, Appellants

(District Court No. 24654 Civil)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

PRESENT: KALODNER and HASTIE, Circuit Judges; and EGAN, District Judge.

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the Order of October 22, 1958 of the said District Court in this case be, and the same is hereby affirmed, with costs.

Attest:

IDA O. CRESKOFF
Clerk

June 24, 1959

Appendix C

Title 15 Purdon's Pa. Statutes §§ 104, 105 and 110 provide:*

"§ 104. Right to vote; how determined.

"The certificate of stock and transfer books, or either, of any corporation of this commonwealth, shall be prima facie evidence of the right of the person named therein to vote thereon, as the owner, either personally or by due proxy. If however objection is taken by an actual stockholder at the time the ballot is tendered, accompanied by a written statement under oath *that the person in whose name such stock stands* on such certificate, or transfer books, and who is offering to vote thereon either in person or by proxy, *is not the owner thereof, either in his own right or as active trustee with the character of his trusteeship disclosed on the face of said certificate, or transfer books in connection with his name*, it shall be the duty of the judges of election to inquire and determine summarily whether the facts are as represented in such statement, and if so, the vote or votes so tendered shall be rejected: Provided, however, that nothing in this section shall be held to prohibit executors, administrators, guardians or trustees created by last will and testament, or by decree of court from voting on stock standing in the name of a decedent, minor, or other beneficiary."

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* Sections 104, 105 and 110, *infra*, are still in force with respect to all railroad and public utility companies in Pennsylvania. Purdon's annotation states each was repealed "insofar as it relates to business corporations by act of 1933, May 5, P. L. 364, art. XII, § 1202" and to "incorporated institutions" as defined in the Act of 1933, May 15, P. L. 624, art. XVI, § 1602." The Court will note that the Railroad company is not subject to the business corporation law since that law excepts therefrom any company "subject to the supervision of * * * The Pennsylvania Public Utility Commission" [15 P. S. § 2852-4 (3)]; and Title 66 P. S. § 1101 et seq. subjects the company to the aforesaid "supervision". An "incorporated institution", as shown by General Index to Purdon's refers solely to "any bank, bank and trust company, savings bank, or trust company." (7 P. S. § 819-1 et seq.).

"§ 105. When beneficial owner of stock may vote.

In cases where, under the terms of the preceding section, the person named in the certificate, or transfer books, is not permitted to vote, the beneficial owner of such stock shall have the right to vote thereon upon furnishing to the judges of election satisfactory evidence of ownership."

"§ 110. Person voting as proxy to make oath; filing of powers of attorney; false swearing.

In all elections of officers in any association or company (incorporated as aforesaid) hereafter to be held by virtue of any law of this commonwealth, whenever any person shall offer to the judges of such election any vote or votes as attorney, proxy or agent for any other person, such person being required thereto by any judge of such election, or any stockholder in such association or company, shall, before his vote or votes shall be received, take and subscribe the following oath or affirmation: I do solemnly swear (or affirm) that I have no interest directly or indirectly in the share upon which I shall vote at this election, *that those shares are to the best of my knowledge and belief truly and in good faith owned by the persons in whose name they now stand* and that in voting at this election I have not transferred any of the said shares, or caused them to be transferred in trust or otherwise for the purpose of increasing the votes at this election, and that I shall not violate in any manner directly or indirectly any provision of the act of incorporation which limits the number of votes a stockholder may give in his own right; and the judges of such election are authorized to administer the aforesaid oath (or affirmation) and the said oath (or affirmation) and also all authorities or powers of attorney to vote by proxy, or as agent, shall be filed and preserved in the office of such association or company, and if any person wilfully and absolutely swear or affirm falsely, in taking any oath or affirmation prescribed by this act, such person so offending shall upon due conviction thereof be subject to the pains and penalties which are by law prescribed for the punishment of wilful and corrupt perjury."

Appendix D.

Title 12 Purdon's Pa. Statutes §§ 1322-1323:

"Section 2. In any such suit instituted or maintained by holder or holders of less than five per centum of the outstanding shares of any class of such corporation's stock or voting trust certificates, the corporation in whose right such action is brought shall be entitled, at any stage of the proceedings, to require the plaintiff or plaintiffs to give security for the reasonable expenses, including attorneys' fees, which may be incurred by it in connection with such suit, and by the other parties defendant in connection therewith, for which it may become liable pursuant to section three of this act, to which security the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may, from time to time, be increased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate.

"Section 3. The reasonable expenses, including attorneys' fees, of any party defendant incurred in connection with the successful defense of such suit shall be assessed upon the corporation, or if any party defendant shall be successful in part only, or if such action shall be settled with the approval of the court having jurisdiction thereof, the reasonable costs, including attorneys' fees, of any such party defendant shall be assessed upon the corporation in such amount as the court shall determine and find to be reasonable in the circumstances. The amount of all such expenses so assessed shall be awarded as costs of the suit and be recoverable in the same manner as statutory taxable costs."